

### State of Idaho

## Legislative Services Office

### Management Report

A communication to the Joint Finance-Appropriations Committee

## OFFICE OF THE STATE TREASURER

**FY 2006** 

Report IC15006

Serving Idaho's Citizen Legislature



# Legislative Services Office Idaho State Legislature

Serving Idaho's Citizen Legislature

Jeff Youtz Director

April 20, 2007

Honorable Ron Crane Idaho State Treasurer Statehouse Mail

Honorable Dean Cameron, Co-Chair Joint Finance-Appropriations Committee 1101 Ruby Drive Rupert, ID 83350

Honorable Maxine Bel, Co-Chair Joint Finance-Appropriations Committee 194 South 300 East Jerome, ID 83338

Dear Treasurer Crane, Senator Cameron, Representative Bell:

We have completed certain financial audit procedures on the Office of the State Treasurer's financial activities that occurred during the fiscal year ended June 30, 2006. The work was performed in accordance with Government Auditing Standards issued by the Comptroller General of the United States. We obtained an understanding of the design of the relevant policies and procedures and internal controls. It was not our intent to provide an opinion on the specific financial statements or the internal controls of the Treasurer's Office, and we do not give such an opinion. The results of these procedures, together with procedures performed at other State agencies, allow us to express an opinion on the statewide basic financial statements prepared by the State Controller's Office and included in the *Comprehensive Annual Financial Report (CAFR)*. The scope of our work included auditing the material segments of the statewide basic financial statements and appropriate procedures, and required tests were performed in order to issue our opinion on the *CAFR*. Any findings and recommendations communicated in this letter will also be included in the statewide *Single Audit Report*.

Based on the limited procedures applied, we conclude the financial operations of the Treasurer's Office meet acceptable standards. Further, the Treasurer's Office substantially complies with laws, regulations, rules, grants, and contracts for which we tested compliance. We have one finding and recommendation to report, which relates to the investments managed by the Treasurer's Office, as a material segment of the basic financial statements for the State of Idaho.

Mike Nugent, Manager Research & Legislation Cathy Holland-Smith, Manager Budget & Policy Analysis Don H. Berg, Manager Legislative Audits Glenn Harris, Manager Information Technology FINDING #1 – <u>Investment amortization of discounts and premiums was not properly accounted for, resulting</u> in erroneous distributions and asset valuations.

The Treasurer's Office manages \$2 billion within several investment pools for various state and local government entities. Investments purchased at a premium, or at a discount from face value, require specific accounting treatment or amortization to ensure that earnings are properly distributed and balances are accurately reported. The process for recording amortization and various other accounting requirements for investments are inherently complex and require specific knowledge and skills.

The Treasurer's Office used an appropriate amortization method to determine income distribution to participants. However, amortization of discounts and premiums on securities were not properly recorded. In addition, investment data provided to participants and posted on the Treasurer's Web site were misstated and did not reconcile with the Treasurer's accounting records.

We also noted that an error in establishing a participant's account was not discovered by staff for almost a year and caused earnings to be distributed in error. Investment strategies outlined in the Treasurer's policies and in Idaho Code were not always followed and could misrepresent the investment objectives to participants.

The Treasurer's Office does not currently have the appropriate accounting expertise available to handle or oversee the complex accounting routines associated with investment reporting. Changes in the custodial bank and a misunderstanding of the amortization process also contributed to the errors.

As a result, the carrying value of investments at June 30, 2006 was overstated by the portion of amortized premiums and discounts. In addition, income was distributed in error during the year, and investment reports to participants were misstated and did not agree with accounting records.

RECOMMENDATION #1 – We recommend that the Treasurer's Office recruit appropriate accounting expertise to manage the complex investment accounting functions. We also recommend that the Treasurer's Office evaluate accounting procedures, methods, and internal controls to ensure that investments are properly recorded and reported in accordance with accounting standards and Idaho Code.

The Office of the State Treasurer has reviewed this information and is in general agreement with its contents. The Treasurer's full response to the above finding and recommendation is attached to this report.

In addition to the finding and recommendation, we discussed other, less important issues which, if changed, would improve internal control, ensure compliance, or improve efficiency.

We appreciate the cooperation and assistance given to us by the Honorable Ron Crane, Idaho State Treasurer, and his staff.

This letter is intended solely for the information and use of the Office of the State Treasurer and the Idaho Legislature, and is not intended to be, and should not be, used by anyone other than these specified parties.

If you have questions, please contact April Renfro, the managing auditor, or me at 208-334-2475.

Yours truly,

Don H. Berg, Manager



#### STATE OF IDAHO OFFICE OF THE STATE TREASURER

ROOM 102 STATEHOUSE P.O. BOX 83720 BOISE, IDAHO 83720-0091

April Renfro Legislative Audits Room 108, Statehouse Boise, ID 83720-0054

April 9, 2007

Dear Ms. Renfro,

In reply to the FY 2006 legislative audit, the Treasurer's Office is in general agreement with the finding included in the report.

The Treasurer's Office changed accounting methodology from cash accounting to accrual accounting during FY 2006. The change resulted in some unexpected results from both the Treasurer's accounting system and the custodial bank's accounting system that took some time to recognize and correct. The Treasurer's Office was aware of these issues prior to the FY 2006 audit and has implemented a strategy to correct the problems with as minimal of an effect to the investment portfolio as possible.

As to the other examples listed in the finding, the Treasurer's Office had identified and corrected many of the issues prior to the FY 2006 audit, and had already implemented internal controls to prevent them from occurring again.

I thank you for the opportunity to respond to the findings in the audit, and appreciate the efforts of the legislative auditors to streamline and improve the operations of our office. We also would like to mention that it is very helpful to have auditors assigned to our office that have the expertise and experience to understand the complex nature of our investment accounting and hope that will be possible for future audits.

Sincerely,

Ron G. Crane State Treasurer

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